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Establishing Claims for Damages, Costs and Interest in International Arbitration

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ESTABLISHING CLAIMS FOR DAMAGES, COSTS AND INTEREST IN INTERNATIONAL ARBITRATION

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INTRODUCTION

In most international arbitrations, one of the purposes of the proceedings is for one party to establish a claim for damages or other compensation. In this lecture, I intend to investigate why it seems that, so often, the party who seeks to establish the claim faces a complex and difficult path, and in many cases, fails to establish the whole or sometimes a major part of its claim.

Lawyers very often concentrate, rightly, on the questions of

* Justice of the High Court, London, England. This paper was originally presented as a lecture at the American University Washington College of Law's 2008 Annual Lecture on International Commercial Arbitration.

liability, which, of course, are the necessary precursors to establishing any claim for damages. One well-known English construction lawyer took the view that the first stage of any proceedings should be a determination of the loss on the assumption that liability would be proved on the basis that it would rarely be necessary to try liability. That is a bold approach of which I was recently reminded when, in a claim worth several million dollars and after a complex trial of liability, the winning party was compensated with only a few hundred thousand dollars, even though the costs far exceeding that sum.

I shall use the word “damages” as a general description that encompasses claims for payment or other compensation, typically under the terms of, or for, breach of a contract, together with interest, and, where recoverable, legal costs. The link between establishing liability and proving damages in complex cases is often difficult, involving issues of causation and a complex assessment of the loss suffered or sum due. The major part of my own experience in international arbitration has involved complex technical disputes, involving construction, IT, and other technology claims. Those claims have particular difficulties and I shall refer to some examples to illustrate the problems.

Whilst even in domestic arbitration or litigation the assessment of damages has its challenges, the international element makes those challenges more difficult and, at the same time, adds further challenges. There has to be some consideration of the legal principles which are to govern the relevant issues. At a simple level this depends on whether the relevant matters are governed by substantive law or procedural law. However, even to answer that question might depend on conflict questions which mean that a decision has to be made as to which legal system governs the question of whether it is a matter of substantive or procedural law. Unsurprisingly, international arbitral tribunals often seek, expressly or inferentially, the comfort of “generally applicable rules in international arbitration.” The adoption of that uncertain concept by a panel drawing from experience in different legal systems is necessarily difficult for counsel to predict in advance.

The path to establishing a claim for damages depends on legal concepts such as causation, foreseeability, mitigation, and

betterment. It also depends on procedural matters, such as burden of proof, and assessment of factual and expert evidence. In addition, it relies on the interpretation of particular obligations under the underlying contract, such as exclusion or limitation of liability provisions and liquidated damages clauses.

Once the damages have been established there may remain issues of interest or costs, which are just as important to the overall recovery.

I.SOME GENERAL PRINCIPLES

In all this uncertainty, I can start with some principles that are frequently referred to as generally applicable rules in establishing damages. The means by which an arbitral tribunal arrives at such principles can be to rely on national law, equity, general principles of law or other transnational concepts such as Unidroit Principles (“UNIDROIT”),¹ particularly Section 4 of Article 7 on damages.²

These are, first, that damages are awarded to put the claimant, as nearly as possible, “in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.”³ This also finds expression in a principle that betterment is irrecoverable, as a party should not be put in a better position.⁴ UNIDROIT Article 7.4.2(1) provides in relation to “[f]ull compensation”:

The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm.

1. Int’l Inst. for the Unification of Private Law [UNIDROIT], Principles of International Commercial Contracts art. 7.4 (2004).

2. See generally Paul-A Gélinas, *General Characteristics of Recoverable Damages in International Arbitration*, in DOSSIER OF THE ICC INSTITUTE OF WORLD BUSINESS LAW: EVALUATION OF DAMAGES IN INTERNATIONAL ARBITRATION (2006).

3. *Livingstone v. Rawyards Coal Co.*, [1880] 5 App. Cas. 25 (H.L.) 39 (Eng.).

4. See Josh M. Leavitt & Daniel G. Rosenberg, *Toward a Unified Theory of Damages in Construction Cases: Part I—Navigating Through the Diminution of Value vs. Cost of Repair Debate in Defect Cases and Allocating Burdens of Proof*, 2(1) J. AM. C. CONSTRUCTION LAW 6, 6 (2008) (explaining the concept of betterment as a “term for certain types of limitations on damages”).

The second principle is that the damages

should be such as may fairly and reasonably be considered either [1] arising naturally, *i.e.* according to the usual course of things, from such breach of contract itself, or [2] such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.⁵

UNIDROIT Article 7.4.4 deals with “[f]oreseeability of harm” and provides: “[t]he non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance.”

The third related principle is the duty to mitigate, which requires a claimant to take reasonable steps to mitigate the loss consequent on the breach.⁶ This prevents the claimant from recovering damages that would have been prevented by such steps. The duty, though, is not a high one and does not generally oblige a claimant to take steps that a reasonable and prudent person would not ordinarily take.⁷

The first principle establishes the general compensatory approach. The second and third principles show that, as a matter of policy, there has to be a limit on the compensatory approach in terms of foreseeability. These principles, like all such principles, are easy to state as the starting point but more difficult to apply to the facts of a particular case.

II. CAUSATION

Let me now turn to causation. Whilst the way in which the concept is expressed may vary in different legal systems, there is always a need for the claiming party to establish what effect the liability had. In terms of English law, it has been stated that “[c]ausation is a mental concept, generally based on inference or induction from uniformity of sequence as between two events that there is a causal

5. *Hadley v. Baxendale*, (1854) 9 Ex. 341, 354 (Eng.).

6. See 22 AM. JUR. 2D *Damages* § 340 (2010) (explaining that “a party cannot recover damages flowing from consequences that the party could reasonably have avoided”).

7. See *British Westinghouse v. Underground Railways Co.*, [1912] A.C. 673 (H.L.) 689 (Eng.); UNIDROIT, *Principles of International Commercial Contracts*, art. 7.4.8 (2004).

connection between them.”⁸ In a simple case of failure to deliver goods, the party who does not receive the goods may suffer a number of effects. First, it may suffer loss of use of the goods. The effect of the loss of use will depend on the use and what action the party takes. If the party was to use the goods for its own personal use then no further question of causation may arise and the issue becomes one of assessment of the loss. If, however, the party was intending to use the goods to produce other goods for resale or is selling those goods on, further investigation of causation will be needed. That investigation, as can be seen, will involve factual evidence to establish what happened as a result of the failure or breach.

Rarely is causation such a simple matter. It is often complicated by two concepts: globality and concurrency. Globality arises because causation is not a simple matter of one cause having one simple, traceable effect, but rather there are often a number of causes having a number of effects which lead to an overall or “global” effect.⁹ This is particularly true in construction, IT, and technology projects, where overall delay and disruption is caused by a multiplicity of events and where causation depends upon an extremely complex interaction between the consequences of various matters so that it is difficult, impracticable, or even impossible to make an accurate apportionment between the several causes.¹⁰ That would not, in itself, be a barrier to the establishment of a claim if all of the causes were proved to the liability of the defendant party. In practical terms, that is not likely to be the case because either the claiming party will fail to prove that all the claimed causes were the liability of the defendant party, or the defendant party will show that there were, in addition, other causes which were the fault of the claimant party and caused loss.

8. *Monarch Steamship Co. v. Karlshamns Oljefabriker*, [1949] A.C. 196 (H.L.) 228 (Eng.).

9. See generally HAL SIRKIN, JIM HEMERLING & ARINDAM BHATTACHARYA, *GLOBALITY: COMPETING WITH EVERYONE FROM EVERYWHERE FOR EVERYTHING* 1-6 (2008) (explaining the term “globality” and recognizing the interconnectivity in the global marketplace).

10. See *Wharf Properties Ltd. v. Eric Cumine Assoc.*, [1991] 52 B.L.R. 1 (Eng.) (stating that “in cases where the full extent of extra costs incurred . . . depend[s] upon a complex interaction between the consequences of various events[,] it may be difficult to make an accurate apportionment of the total extra costs”).

In addition, in such cases, there is an overall delay and financial effect. Even if all the alleged causes are shown to be the liability of the defendant party, how can it be established that the result was the overall delay and financial effect? While causation is a matter of fact, this does not mean that it has to be proved by direct factual evidence. Rather, as I have said, it can be proved from inference or by a process of induction or deduction from the facts. If, as a matter of liability, the defendant has committed a number of breaches of contract that would be expected to cause delay and disruption to a project, then that may be sufficient to establish the claim. Often, in such cases, the facts and the inferences will emerge only during a trial and perhaps the analysis of that evidence will occur only during the course of closing submissions, because, naturally, the claimant has been concentrating on establishing liability. In such cases, the Tribunal is likely to be concerned with the principle of fairness: has the claimant put forward its case sufficiently to alert the defendant to the case which is going to be made against it so that it knows the case it has to meet?¹¹

The second related problem is that of concurrency of causes.¹² Suppose that it can be shown that there are one or more causes of delay and disruption that are the fault of the defendant party, but, at the same time, that there were equal causes of delay and disruption that were the responsibility of the claiming party. In a global claim, this problem is likely to arise. Because of the underlying globality, there are likely to be concurrent causes that lead to the global delay and disruption. Even in a simple case, problems of concurrency can arise.

Take an example of a power station where one of the final activities is the connection of the power station to the local power supply system or grid for the purpose of exporting or transferring the

11. See U.N. Comm'n on Int'l Trade Law [UNCITRAL], UNCITRAL Model Law on Commercial Arbitration, U.N. Doc. A/40/17, U.N. Sales No. E.08.V.4, arts. 18, 23(1), 25 (2008) (establishing a framework within which both the claimant and respondent must identify the claims or defenses they are making, and identify and produce all relevant evidence).

12. See 57A AM. JUR. 2D *Negligence* § 515 (defining concurrent causation as either that which happens contemporaneously with the "defendant's conduct to bring about an injury" or as "two separate and distinct causes that operate contemporaneously to produce a single injury").

power generated at the plant. Usually this is a matter for which the owner/client is responsible and it is then followed by the necessary testing which is part of the contractor's work. Suppose the owner, despite best efforts, has been unable to arrange the connection to the grid in time, and, as seen at that time, this will prevent the contractor from being able to complete the work. As predicted, the contractor reaches the final activity, which is the testing of the generators prior to needing the connection to the grid. Suppose, then, that on the final day of testing one of the generators catches fire and is destroyed. This means that the contractor cannot complete the work necessary to connect to the grid. In the end, after a further three months delay, the contractor replaces the generator and completes testing prior to needing the connection to the grid. But, at the same time, the owner makes available the delayed connection to the grid. Who is liable for the delay and disruption caused by the resulting delay of three months? Can the owner or the contractor recover damages for the delay? There is no simple answer. Suppose that the contractor chose a long delivery replacement for the generator rather than a shorter period on the basis that he realized the grid connection would not be ready. Suppose that the owner decided not to chase the government electricity commission until it was clear when the replacement generator would be installed. This, I hope, illustrates the complex factual position and justifies the common refrain from the lawyer that "it all depends on the facts."

III. BURDEN OF PROOF

The importance of the question of burden of proof in any given case is often a reflection of the view of the tribunal on the cogency of the evidence that has been placed before it. The difficulties to which I have referred above often mean that the burden of proof gains importance in the closing stages of the hearing and in the award. There are various analyses in different legal systems that relate to the burden of proof. The underlying common principle is that a claimant must prove its claim.¹³ In adversarial systems, the position is rarely

13. See generally Ivo Giesen, *The Reversal of the Burden of Proof in the Principles of European Tort Law: A Comparison with Dutch Tort Law and Civil Procedure Rules*, 6 *UTRECHT L. REV.* 22 (2010); G.L. Peiris, *The Burden of Proof and Standards of Proof in Criminal Proceedings: A Comparative Study of English Law and a Codified Asian System*, 22 *MALAYA L. REV.* 66, 66 (1980).

as simple as placing the burden of every allegation on the claimant. There are often matters where the burden is placed on the other party because it is for that party to raise and prove that aspect. For instance, if a claimant establishes that it has suffered a loss, the question whether the whole of that loss is recoverable usually places an initial burden on the defendant. Thus, in terms of mitigation, it falls on a defendant to prove an allegation of failure to mitigate.¹⁴

Beyond the pure burden of proof, there is also an evidentiary burden. Where a claimant establishes a claim, for instance, by producing an invoice supported by oral testimony that the cost has been incurred due to a cause, there is an evidentiary burden on the defendant to displace that statement either by cross-examination or by adducing its own evidence.¹⁵ This, in turn, may lead to the evidentiary burden shifting to the claimant. In the end, the tribunal has to be satisfied that the claimant has established its case, and must take account of all of the evidence. Similarly, if the defendant raises an allegation that the claimant has failed to act reasonably, then there is an evidentiary burden on the claimant to displace that contention once the defendant has identified something that appears unreasonable.

IV. ASSESSMENT OF FACTUAL AND EXPERT EVIDENCE

There are potentially a number of different approaches that can be taken to the assessment of factual and expert evidence in international arbitration. There are differences between common law, civil law, Sharia law, and other legal systems in the ways in which they treat evidence. And, this must be borne in mind in deciding how to adduce evidence.

An initial question, particularly in terms of establishing claims, is the extent to which a tribunal will accept documents as proof of the facts that are contained within them. The question of whether a document is genuine is obviously an essential first step. Generally,

14. See 22 AM. JUR. 2D *Damages* § 340 (2010).

15. See generally JEAN-FRANÇOIS POUDRET & SÉBASTIEN BESSON, *COMPARATIVE LAW OF INTERNATIONAL ARBITRATION* 550-51 (2007) (identifying challenges regarding the evidentiary burdens placed on arbitral tribunals and parties to arbitration proceedings).

documents are presumed to be genuine; that is, they have been created by the person to whom the document is attributed on the date set out in that document.¹⁶ Most tribunals require a party challenging the genuineness of a document to identify that challenge at an early stage so that the other party has an opportunity to deal with the challenge.¹⁷

On the question of a document being genuine, the truth of its contents is usually the basis for challenge, particularly where the facts depend upon the judgment of the person asserting the facts. The main question is whether the author of the document should be called in order for the truth of the content to be established. In some jurisdictions, there is a laborious process by which a witness, either in oral evidence or in a written witness statement, refers to and exhibits each individual document, and attests to the fact that it is genuine and that its contents are true, so that the document may be admitted into evidence. That procedure is rarely used in international arbitration.

Obviously if the genuineness of a document is challenged, or, in the case of documents central to the case, if the truth of the contents is challenged, then it is desirable that the author or another person with contemporaneous knowledge should be called to meet the challenge, but that is not always possible. In such cases, an arbitral tribunal is unlikely to reject the document outright because the document has not been “proved” by the author.¹⁸

The more usual approach in international arbitration, and increasingly in civil cases in common law jurisdictions, is for the

16. See ALAN REDFERN & MARTIN HUNGER, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 298-99 (4th ed. 2005) (noting that it is not customary for tribunals to require that litigation documents include a guarantee of authenticity).

17. See *id.* at 301 (explaining the procedures outlined in case of a dispute over documents, including sufficiency of document production, compromise agreements, and limitations in scope of discovery).

18. Cf. *Bilcon of Del. v. Canada*, Procedure Order 3 (Perm. Ct. Arb. 2009), available at <http://www.pca-cpa.org/upload/files/Bilcon-ProceduralOrderNo3.pdf> (explicating the various procedures promulgated by the Arbitral Tribunal, including the rule of “[t]ruth and completeness,” which advises the parties that “all documentary evidence submitted to the Tribunal shall be deemed true and complete, including evidence submitted in the form of copies, unless a Disputing Party disputes its authenticity or completeness”).

tribunal to admit into evidence all documents which are put before it and, where a challenge is made, to treat it as a matter going to the weight to be given to the document rather than to its admissibility.¹⁹

The use of expert evidence to support a quantum claim is widespread in international arbitration.²⁰ Very often, the engagement of the expert is used as a means of presenting the case on quantum rather than limiting the expert's involvement to purely expert accounting issues or matters which require expertise in assessing the sum to be claimed. This can have advantages and disadvantages.

I now turn to consider particular aspects of the presentation of claims, starting with delay and disruption claims.

V. PRESENTATION OF THE CLAIM

A. DELAY AND DISRUPTION CLAIMS

The first requirement for presentation of any claim is a proper analysis of the facts. There is a natural and traditional tendency in relation to delay and disruption claims to assume that the task is impossible, and therefore, to avoid even trying to make a proper analysis.²¹ However, an analysis will show that some causative events are better than others in the sense that they are stronger in terms of establishing liability and more likely to lead to an inference that some substantial degree of delay or cost is likely to have been caused by that event.²² The analysis and presentation of the facts should be aimed at establishing not only the scope and extent of the event, but also what the immediate effect was. For instance, a late requirement to change a piece of a plant on a project, as a bare allegation, is unlikely to persuade a tribunal, but if someone can explain the scope and extent of the necessary design, supply, and

19. *Id.*

20. Cf. Andrew Newcombe, *The Strange Case of Expert Legal Opinions in Investment Treaty Arbitrations*, KLUWER ARB. BLOG (Sept. 18, 2010, 3:20 PM), <http://kluwerarbitrationblog.com/blog/2010/03/18/the-strange-case-of-expert-legal-opinions-in-investment-treaty-arbitrations/> (questioning the utility of expert opinions in investment treaty disputes).

21. See Ajibade Ayodeji Aibinu, *Avoiding and Mitigating Delay and Disruption Claims Conflict: Role of Precontract Negotiation*, 1 J. LEGAL AFF. & DISP. RESOL. ENGINEERING & CONSTRUCTION 47, 48 (2009).

22. See *id.* (reviewing the types of costs associated with, and directly related to, claims of delay and disruption).

installation activities, and explain what immediate effect it had on work in the plant, then that will enable a party to show a tribunal that the foundation for an inference of delay and cost is present.

The claim should be divided up into discrete parts. This may be a division based on particular areas of a project, particular activities or trades, or particular time periods. It may also be a combination of these. This allows the case to be presented to the tribunal in a logical manner and assists the tribunal to understand the factual position more easily. A completely global claim that piles up allegations and evidence with the hope that the tribunal will be overwhelmed by their complexity and will accede to a large claim is likely to fail outright.

The use of sophisticated computer generated analysis that conceals everything except an end result, the “black box” approach, is a dangerous way to proceed.²³ First, the tribunal has no way of understanding the evidence as it is provided with only the conclusion. Second, all analyses are based on assumptions, and if a major assumption is shown to be wrong, the analysis will be worthless. If it is more transparent, for instance, by considering the sensitivity of the analysis to the assumptions, it is likely to overcome this difficulty. Third, the facts that have been analysed must be apparent and explainable for the same reason. In summary, the analysis alone is useless, as the tribunal must find the necessary facts, make the necessary inferences, and come to the appropriate conclusions based on the evidence.

Computer generated analyses can be extremely useful in assisting the tribunal to come to its conclusions, provided that certain steps are taken. It is important to have a baseline “intended” and an actual “as-built” program. These should be the subject of early expert discussions in an attempt to reach agreement or narrow the differences between the parties. What is undesirable is that both parties provide the tribunal with analyses that are “ships passing in the night” because they each start from a different base program and

23. Cf. Pablo Florian & Mike Walker, CRA Competition Policy Discussion Papers, The Correct Approach to the Use of Empirical Analysis in Competition Policy 3 (Aug. 2003), *available at* http://www.crai.com/ecp/assets/CRA_DP7.pdf (criticizing the “black box” approach to presenting empirical evidence within the competition policy context as “not transparent” and “not accessible” because it forces parties to blindly trust the experts that analyzed the underlying data).

therefore cannot easily be compared. In international arbitration, it is not uncommon for the tribunal to give early directions for experts to meet and seek to agree upon the foundations for their analyses, with the tribunal resolving any differences in approach as a matter of case management at that stage.²⁴

Any analysis then performed on the baseline program must then be firmly rooted in reality. It must take into account any changes in resources or in logic that have actually been made. For instance, if the workforce has been doubled or a piece of a plant with a larger output has been used, then it is unrealistic to seek to base the analysis of delay on the basis of the original resources. The analysis should have a narrative so that the change can be explained in terms of cause and effect. It must, of course, also be factually correct. The purpose of such an analysis is to show that there is a factual connection or "nexus" between cause and effect, or, at least, that there is an inference to be drawn linking the two.

Often parties seek to present a number of different approaches to try to support the overall conclusion that they should succeed. Experience shows that the greater the number of different approaches used in a given case, the less the impact of the chosen or primary analysis. Frequently, the different approaches can be shown to have inconsistencies that undermine all of the approaches. Whilst a party may choose to consider a number of ways of analyzing the position, it is important that a decision be made on the single approach that is to be used to present the case. Where it is thought that different approaches might strengthen the case, it is necessary to confirm that such a conclusion is correct, and to make sure that the facts and assumptions are the same.

Whatever analysis is produced, it is important to present the key findings of the analysis in a clear way. It is not just the overall conclusion that is of importance, but the steps along the way.

24. See JOHN A. TACKABERRY, RONALD BERNSTEIN & ARTHUR L. MARRIOTT, 1 BERNSTEIN'S HANDBOOK OF ARBITRATION AND DISPUTE RESOLUTION PRACTICE 332 (4th ed. 2003) ("Modern case management requires that the experts should be encouraged to meet, to agree upon issues and to record their agreement and disagreement on points of fact and opinion.").

B. LOSS OF PROFIT CLAIMS

Claims for loss of profits often arise in international arbitrations and they have a number of features, which make them particularly difficult.²⁵

The initial problem is that an assessment of the lost profits may depend on projections derived from past profits, estimated profits included within the price or, particularly for new companies or projects, market projections made historically or after the dispute arose of future profit.²⁶ All of these methods have difficulties. As to the first, it is unfailing that past profits are not an indication of future profits. Although the shorter the time between past profits and those predicted the better, the financial viability of projects can change rapidly and depend on one event. Often, though, the profitability relied upon to establish a claim on a particular project is that of the whole company. The profits will, therefore, be derived from a number of projects, often different from the project in question, and probably with wide fluctuation in profitability across the various projects.

The second approach assumes that the prediction of profit at the time of tender was robust and likely to be the same as the outturn profit. There has to be some proof that the initial projection was robust and any assumptions have been made out. Necessarily, such claims arise on projects where things have gone wrong, and this makes the relationship between the prediction and reality difficult to establish. Analyses of costs and income often show that, even before the claimed events had an impact, profitability was not attained. The final approach base on market projections is particularly difficult, as the underlying assumptions are usually derived from market sector or similar projects, all of which can usually be distinguished on the facts, particularly in international transactions or on international projects.

A further problem arises where the loss will be sustained not just over a short period immediately after the facts giving rise to the

25. See generally John Y. Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEO. J. INT'L L. 61 (2004) (noting that injured parties often receive awards of lost profits rather than awards based on actual loss, and analyzing the extent to which lost profit awards compensate injured parties).

26. See *id.* at 62.

dispute, but will, instead, be suffered over an extended period many years into the future.²⁷ Take, for instance, the failure of a coal mining machine that leads to a delay to the start of coal production or a similar delay to the start of oil or ore production. In such a case, there will be no overall loss of production because the “lost” production will be available at the end of the delay to the start of production. Instead, there will be a delay in receipt of the net income stream. What happens then is that the net present value of that planned income stream has to be compared with that for the delayed income stream. However, in calculating the predicted income stream, the main factors are the predicted oil, coal, or ore prices over time, and the operating costs over time. A large increase in net income caused by delay may mean that there is no overall loss in net current value, or, at best, there may be uncertainty because of the difficulty of predicting future costs and prices in, say, twenty-five years, which are a necessary part of the calculation.

The third problem is establishing what rates of interest for past losses, or rates of discounting for future losses, have to be used in the calculation, and the periods of time over which figures have to be compared.²⁸ Given the volatility in world interest rates, the appropriate rates for interest and discounting may be difficult to predict. However, provided the period is long enough, the net future income after, say, fifteen years may be very small. In some cases, what is lost is a year of operation which, in the case of a fixed term DFBO contract,²⁹ may give rise to a simpler claim without the same problems. However, even in that case, which year is lost? The profile of profits might be less at the beginning and the end. Is the loss that of a year in the middle?

VI. EXCLUSION AND LIMITATION OF LIABILITY

Most sophisticated international contracts include provisions which seek to exclude or limit liability. Such clauses obviously have

27. See *id.*

28. See *id.* at 90.

29. See David W. Gaffney, *Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships in the United States*, 39 PUB. CONT. L.J. 351, 362 (2010) (describing a contract between two parties intended to design, finance, build, and operate a structure).

to be construed in the light of the applicable substantive law.³⁰ This may raise a number of questions: is the exclusion or limitation clause valid under local law; does the exclusion clause cover direct, indirect and consequential damages, and how are those terms defined under local law; do the limitations apply to all claims in contract and in tort, including negligence and fraud?

VII. LIQUIDATED DAMAGES

Many international contracts have liquidated damages clauses that may also contain a limitation or cap on recovery of liquidated damages. These clauses are obviously intended to avoid the complex arguments about the losses which are suffered if, for instance, delivery of a plant is delayed or if the performance of the plant does not reach certain defined levels.³¹

The meaning and effect of such clauses is, of course, a matter for interpretation, taking into account the relevant substantive law. The common law approach is generally to give these clauses full effect unless the sum agreed can be seen to be a penalty on the basis that the sum stated as liquidated damages does not form a genuine pre-estimate of the damages that might be suffered.³² In some civil law countries, or applying UNIDROIT Article 7.4.13, there is an ability for the courts (or, where appropriate, the arbitral tribunal) to revisit the agreed sum should it be patently excessive or ridiculously low, or if it is “grossly excessive in relation to the harm resulting from the non-performance and other circumstances.”³³

This indicates that in some cases the parties will have to assess, in the common law situation, what was the maximum loss that could have been contemplated at the time of the contract or, in the civil law position, what the actual losses are so that it can be seen whether the liquidated damages are sufficiently excessive or low to justify intervention to avoid the agreed sum.

30. See JULIAN D. M. LEW, LOUKAS A. MISTELIS & STEFAN KRÖLL, *COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION* 298-99 (2003).

31. See generally BRIAN EGGLESTON, *LIQUIDATED DAMAGES AND EXTENSIONS OF TIME IN CONSTRUCTION CONTRACTS* 1-7 (2d ed. 1997) (clarifying the history, purpose, and intent of liquidated damages clauses).

32. *Id.* at 5.

33. UNIDROIT, *Principles of International Commercial Contracts*, art. 7.4.13 (2004).

VIII. APPROACH TO ASSESSMENT

From the issues identified in this lecture, it can be seen that establishing damages, particularly in international arbitration, has as many challenges as establishing liability. Frequently, though, the quantification of the claim and the preparation of evidence to support it are left to one side. As Josh Leavitt and Daniel Rosenberg say in their recent articles in the ACCL journal, which concentrated on domestic claims, “damages are often the least understood, least emphasized and last aspect of a case to be analyzed.”³⁴ They say that by the time that damages come to be dealt with, tired counsel are addressing tired arbitrators.³⁵

What then is the approach taken in relation to assessment of damages, given these difficulties? Some tribunals tend to avoid making any decision, seeking to cast the obligation on the experts or even the parties to deal with quantum. Other tribunals find the obvious difficulties a convenient reason to conclude that a party has not established its case. It is suggested that the correct approach should be pragmatic along the lines expressed in the following decisions in common law jurisdictions.³⁶

The first was in the case of *Chaplin v. Hicks*³⁷ where the court had to assess damages on the basis of the loss of an opportunity to appear in a beauty contest.³⁸ The claimant was one of fifty women selected for an interview in respect of twelve contracts available for work as actresses in theatres.³⁹ Because of a breach of contract on behalf of the organizers, she was unable to attend on the day fixed for interview, and sought damages in respect of the lost opportunity of being selected for employment.⁴⁰ It was held that she had not been afforded a reasonable opportunity of presenting herself for selection,

34. See Josh M. Leavitt & Daniel G. Rosenberg, *Toward a Unified Theory of Damages in Construction Cases: Part II - The Search for Unifying Theories in Common Law and Statutory Approaches to Treatment of Prejudgment and Postjudgment Interest Awards on Prevailing Construction Damage Claims*, 2(2) J. AM. C. CONSTRUCTION LAW. 1 (2008).

35. See generally *id.*

36. See *infra* notes 42, 49.

37. [1911] 2 K.B. 786, 786 (Eng.).

38. *Id.*

39. *Id.* at 787.

40. *Id.* at 788.

and damages were assessed at a lump sum of £100.⁴¹ The defendants appealed, alleging, amongst other things, that the damages were “so contingent as to be incapable of assessment.”⁴² The English Court of Appeal disagreed, and Vaughan Williams, L.J. said:

[t]hen came the point that was more strenuously argued, that the damages were of such a nature as to be impossible of assessment. It was said that the plaintiff's chance of winning a prize turned on such a number of contingencies that it was impossible for any one, even after arriving at the conclusion that the plaintiff had lost her opportunity by the breach, to say that there was any assessable value of that loss. It is said that in a case which involves so many contingencies it is impossible to say what was the plaintiff's pecuniary loss. I am unable to agree with that contention. I agree that the presence of all the contingencies upon which the gaining of the prize might depend makes the calculation not only difficult but incapable of being carried out with certainty or precision. The proposition is that, whenever the contingencies on which the result depends are numerous and difficult to deal with, it is impossible to recover any damages for the loss of the chance or opportunity of winning the prize. In the present case I understand that there were fifty selected competitors, of whom the plaintiff was one, and twelve prizes, so that the average chance of each competitor was about one in four. Then it is said that the questions which might arise in the minds of the judges are so numerous that it is impossible to say that the case is one in which it is possible to apply the doctrine of averages at all. I do not agree with the contention that, if certainty is impossible of attainment, the damages for a breach of contract are unassessable. I agree, however, that damages might be so unassessable that the doctrine of averages would be inapplicable because the necessary figures for working upon would not be forthcoming; there are several decisions, which I need not deal with, to that effect. I only wish to deny with emphasis that, because precision cannot be arrived at, the jury has no function in the assessment of damages. . . . There were, as there are now, many cases in which it was difficult to apply definite rules. . . . In such a case the jury must do the best they can, and it may be that the amount of their verdict will really be a matter of guesswork. But the fact that damages cannot be assessed with certainty does not relieve the wrongdoer of the necessity of paying damages for his breach of contract.”⁴³

This approach was also reflected in the Canadian case of *Wood v. Grand Valley Railway Company*,⁴⁴ where a railway company agreed

41. *Id.*

42. *Id.*

43. *Id.* at 791-92.

44. [1915] 51 S.C.R. 283, 283 (Can.).

to build an extension to the railway into a town to secure the benefit of competitive freight rates, if the manufacturers and citizens of the town purchased railway bonds. In assessing damages for breach of that agreement, Davies, J. said:

[i]t is clearly impossible under the facts of that case to estimate with anything approaching to mathematical accuracy the damages sustained by the plaintiffs, but it seems to me to be clearly laid down there by the learned judges that such an impossibility cannot 'relieve the wrongdoer of the necessity of paying damages for his breach of contract' and that on the other hand for the tribunal to estimate them whether jury or judge must under such circumstances do 'the best it can' and its conclusion will not be set aside even if the amount of the verdict is a matter of guess work.⁴⁵

These decisions are also reflected, to some degree, in UNIDROIT article 7.4.3, which refers to "[c]ertainty of harm" and provides:

- (1) Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty.
- (2) Compensation may be due for the loss of a chance in proportion to the probability of its occurrence.
- (3) Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court.⁴⁶

This pragmatic approach to assessment is not always followed. Experience shows that the approach to be taken by a particular tribunal will depend on the view of the tribunal as to the merits of the underlying dispute, and also the inclination or ability of the tribunal to carry out the necessary investigation or assessment.⁴⁷ Often, this leads to a tribunal coming to the conclusion that it should dismiss the claim because the damages cannot be established with the degree of certainty which is thought to be appropriate, or the damages are said

45. *Id.* at 289.

46. UNIDROIT Principles of International Commercial Contracts, art. 7.4.3 (2004).

47. See, e.g., MARK KANTOR, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION EVIDENCE, AND EXPERT EVIDENCE 6-7 (2008) (highlighting the issues an arbitrator must address in adopting a valuation method, such as the inherent purposes of the award, whether applicable bright line rules exist, whether the evidence presented is persuasive, and the possible consequences of uncertainty in estimations).

to be “speculative.”⁴⁸

It is suggested that these two reasons are often relied on when, perhaps with better presentation, the tribunal could have been persuaded to make an award.⁴⁹ If a party can show that it has suffered an actionable wrong, whether in contract or tort, the tribunal should seek to make an award of damages. The fact that certainty is not possible or that the exercise requires the tribunal to speculate about outcomes should not deprive a party from some form of recovery.

An example of a case where lost profits were not awarded by a distinguished panel of civil law arbitrators is the ICSID case of *Aucoven v Venezuela*,⁵⁰ where the claimant had undertaken to build a bridge as part of a thirty year concession agreement, but had no record of profit, as the bridge was not built.⁵¹ The tribunal, basing itself on the jurisprudence of the Venezuelan Supreme Court, said that it could not award loss of profit on the basis of speculative assessments, and stated that this was consistent with the practice of international tribunals, which they said “have often dismissed claims for lost profits in cases of breach of contract on the ground that they were speculative and that the claimant had not proven with a sufficient degree of certainty that the project would have resulted in a profit.”⁵² They also found that the Venezuelan Government’s case that there would be no profit was convincing.⁵³

The principle of Venezuelan law was expressed in this way:

[i]t is necessary for the claimant to provide the necessary evidence, not necessarily demonstrative, but evidence not based on speculation, or on the mere possibility of making a profit. If it is not possible to present credible evidence, at least the claimant must provide evidence that allows

48. See, e.g., *Piscitelli v. Friedenberg*, 87 Cal. App. 4th 953, 989 (2001) (reaffirming the principle that “damages which are speculative, remote, imaginary, contingent, or merely possible cannot serve as a legal basis for recovery”) (citations omitted).

49. See LEW, MISTELIS, & KRÖLL, *supra* note 35, at 648-49.

50. *Autopista Concesionada de Venez., C.A. v. Bolivarian Republic of Venez.*, ICSID Case no. ARB/00/5, Award (Sept. 23, 2003).

51. See *id.* ¶¶ 21-31, 362 (setting out the terms of the concession agreement and holding that Aucoven showed no profits through the record).

52. *Id.* ¶ 351.

53. *Id.* ¶¶ 337-39 (summarizing Venezuela’s position that no lost profits could be claimed because when discounting the future cash flow at the proper rate the net result would be zero).

the establishment of indicia that allow the presumption that effectively [the claimant] had the opportunity to make a profit and could not [do so] as a result of the breach of the other party.⁵⁴

The tribunal rejected Aucoven's submission that lost profits, if awarded, should be computed on the basis of the expected cash flows under the Concession Agreement, using the shareholder flow line appearing in the Economic-Financial Plan of the Concession Agreement.⁵⁵ The shareholder cash flow line represented a figure of over 15 percent real annual return, which Aucoven would have earned on its projected investment over the thirty-year Concession period.⁵⁶

A case that went the other way was the arbitration between Karaha Bodas Company ("KBC") and PLN concerning a geothermal power project in Indonesia that proved unnecessary because of the 1997 downturn in Asian currencies.⁵⁷ The Tribunal awarded KBC both expenses incurred of \$111 million and lost profits of \$150 million.⁵⁸ As argued by Louis Wells in his article questioning the damages awarded, this would appear to be "double dipping," giving KBC both its wasted expenditure and lost profits.⁵⁹

These two cases illustrate the divergence in approach adopted by two different tribunals: one rejects the claim, while the other overcompensates for the claim. Somewhere in the middle is an approach which I suggest should be more common. Whether that was based on a difference in the cogency of the evidence and submissions, or a difference of approach by the tribunal, it demonstrates the uncertainty inherent in establishing such claims in international arbitration.

54. *Id.* ¶ 349.

55. *Id.* ¶ 355-56.

56. *Id.* ¶ 354.

57. See *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 364 F.3d 274, 282-83 (5th Cir. 2004).

58. *Id.* at 285.

59. Louis T. Wells, *Double Dipping in Arbitration Awards? An Economist Questions Damages Awarded to Karaha Bodas Company in Indonesia*, 19 ARB. INT'L 471, 472-73 (2003) (arguing that the arbitrator's failed to properly characterize the nature of the transaction in determining how to calculate KBC's damages).

IX. INTEREST

In addition to questions of damages, another aspect which is often lost sight of is a claim for interest.⁶⁰ With large projects taking many years and international arbitrations taking similar times to provide a resolution of the disputes, the sums can often be a significant percentage of the overall claim.

This raises a number of issues in the context of international arbitration. First, there is a question whether interest is a matter of substantive or procedural law. Sometimes tribunals seek to overcome a difficulty that arises where there are substantive law provisions that restrict or prevent interest from being payable. They accept, instead, an argument that the question of interest is a matter of procedural discretion for the tribunal, based on general principles of international commercial arbitration.

Second, there are many countries that apply some form of limitation on the ability to recover interest. In Saudi Arabia, where the civil law is based on Sharia law, there is a complete prohibition on interest (*riba*) on the basis that interest is a form of usury, which is prohibited by the Quran.⁶¹ In other Islamic countries, such as Kuwait, a distinction has been drawn between normal civil liabilities between individuals in which interest is prohibited, and commercial transactions where provisions of the Commercial Code allow the recovery of interest.⁶² If in cases where interest is prohibited the tribunal attempts to overcome that by relying on the argument that interest is in the discretion of the tribunal, this may cause difficulties in the enforcement of awards. If the award comes to be enforced in a country where, as matter of public policy, awards of interest are unenforceable, then not only may the award of interest be

60. See LEW, MISTELIS & KRÖLL, *supra* note 35, at 655-56 (acknowledging the lack of consensus in arbitration regarding awards for interest and outlining the questions that must be addressed by the tribunal in making such a determination, including whether the debtor is liable, the appropriate interest rate, the date from which interest should be paid, and whether it should be compounded).

61. Mark Wakim, *Public Policy Concerns Regarding Enforcement of Foreign International Arbitral Awards in the Middle East*, 21 N.Y. INT'L L. REV. 1, 8-9 (2008).

62. Christie S. Warren, *Commercial Law*, in THE OXFORD ENCYCLOPEDIA OF THE ISLAMIC WORLD, OXFORD ISLAMIC STUDIES ONLINE, <http://www.oxfordislamicstudies.com/article/opr/t236/e0156> (last visited Oct. 1, 2011).

unenforceable, but also the remainder of the award may be rendered unenforceable because it is "infected" by the breach of public policy, or cannot be severed.⁶³

Third, there is often a question of whether pre-arbitration interest is recoverable. In many jurisdictions, the substantive law provides that the courts can award interest only for the period after proceedings have been commenced and this is applied, often by analogy, to arbitration proceedings. In such cases, resort has to be made either to express provisions of the contract, or to general principles of international commercial arbitration to fill the gap.⁶⁴

Even where the tribunal has a complete discretion there are also the questions of the period for interest, the rate of interest, and whether interest should be simple or compounded.⁶⁵ Should the recovering party recover interest from the time they incurred the loss, from the time they made a claim, or from some other date? Should the period of interest be the whole period up to the date of the award on the basis that one party has been deprived of the use of the money and the other has had the benefit of it? Should some period be excluded, such as a period of delay in pursuing the claim? What should be the rate of interest? What should be the base rate for the currency? Should it be LIBOR,⁶⁶ EURIBOR,⁶⁷ or the base rate of a national bank? If so, should there be a percentage uplift to represent the rate at which a claimant could borrow, or a decrease to reflect the rate of interest it could earn? Should interest be calculated on the

63. See Wakim, *supra* note 67, at 10, 40-49 (warning of the potential for *riba* and *gharar* to void arbitration awards and surveying how the practice of international arbitration has developed to address the impact of these principles).

64. See KANTOR, *supra* note 52, at 265-66 (outlining the hierarchy of sources to turn to for determining whether interest should be awarded and in what amount, looking first to the parties agreement, then to statutes and treaties, and then to the arbitrator's discretion).

65. See *id.* at 274-75 (expressing that no uniform practice exists and providing examples of common trade usage where compounded interest is utilized, such as deposits in financial institutions and bonds, to help guide arbitrators in making the determination of whether to award compounded interest).

66. See *id.* at 267-70 (explaining the practical significance of the London Interbank Offered Rate and how that formula can be utilized in calculating interest awards).

67. See *About Us*, EUROPEAN BANKING FEDERATION, <http://www.euribor-ebf.eu/euribor-ebf-eu/about-us.html> (last visited Oct. 1, 2011) (explaining that Euro Interbank Offered Rate is the money market reference rate for the euro).

basis of simple interest, or should it be compound interest to reflect commercial borrowing? And, if so, should it be compounded monthly, quarterly, or annually?

A related question, particularly for loss of profit claims, is the question of discounting an award for future profits to allow for the fact that the sum awarded represents an accelerated receipt of that future interest. Methods, such as discounted cash flow, are often applied, but the question of rates of discount is often disputed. On many analyses, the net present value of sums that are received now in respect of profits that would have been earned fifteen or more years into the future is so small that no award realistically flows.⁶⁸

X. COSTS

Finally, an aspect that is often ignored in international arbitration is the question of the award of costs, which represent the legal costs incurred by the parties, and the sums which are paid to any arbitral institution and to the tribunal. The ways in which costs are awarded and assessed are good examples of the need for a fresh approach. Aspects of practice and procedure must be considered anew without the assumption that the rules customarily applied in domestic cases are applicable to such cases.⁶⁹ Even where practitioners come from legal systems which have costs recovery, there are still lessons to be learned. Like interest, the sum claimed in terms of the costs of the arbitration can often exceed the sums at stake and the sums awarded.

There are two aspects to the award of costs: 1) the decision as to which party, in principle, will bear the costs; and 2) the decision regarding recoverable costs which that party has to bear. The rules in international arbitration frequently contain a wide discretion on costs. The International Chamber of Commerce ("ICC") Rules of Arbitration contain this provision at Article 31:

2. [D]ecisions on costs other than those fixed by the Court may be taken

68. See, e.g., *Autopista Concesionada de Venez., C.A. v. Bolivarian Republic of Venez.*, ICSID Case no. ARB/00/5, Award, ¶¶ 337-39 (Sept. 23, 2003) (summarizing Venezuela's position, which was supported by the tribunal, that when the future cash flow was discounted at the proper rate, the net result for the lost profits claimed was zero).

69. See GARY B. BORN, *INTERNATIONAL COMMERCIAL ARBITRATION* 2488, 2497-2500 (2009).

by the Arbitral Tribunal at any time during the proceedings.

3. The final Award shall fix the costs of the arbitration and decide which of the parties shall bear them or in what proportion they shall be borne by the parties.⁷⁰

In relation to the first aspect, which party should bear costs, there are a number of approaches. One approach is based on ascertaining the overall winner and awarding that party costs on the basis that costs follow the event.⁷¹ Another is to look at apportioning costs depending on success on particular issues in the arbitration, either by awarding a percentage of the overall costs or costs of the particular issues.⁷² Sometimes, an award of costs makes separate awards to the claimant for costs incurred in pursuing claims and to the defendant for costs of pursuing cross claims.⁷³ Some tribunals like to make the award of costs reflect the degree of success on the claim, so that a percentage is awarded to reflect the difference between the sum awarded and the sum claimed.⁷⁴ Finally, the tribunal may reduce costs or eliminate the costs incurred during a particular period to reflect unreasonable conduct of one party prior to or during the arbitration.⁷⁵

In relation to the second aspect, the quantum of recoverable costs, there are also a number of different approaches. One approach is for the tribunal to make a detailed assessment of the costs incurred by a

70. International Chamber of Commerce Rules of Arbitration, art. 31 (1998), available at http://www.iccwbo.org/uploadedFiles/Court/Arbitration/other/rules_arb_english.pdf.

71. See, e.g., BORN, *supra* note 75, at 2489-90 (discussing cost awards under the English Arbitration Act).

72. See Winston & Strawn, Briefing: International Arbitration Practice 2-3 (2007), available at http://www.winston.com/siteFiles/publications/Arbitration_Costs.pdf.

73. See, e.g., London Court of International Arbitration [LCIA], Arbitration Rules, art. 26.7 (1998) (granting arbitrators the authority to issue separate awards on different issues at different times, thus allowing for separate cost awards for separate claims).

74. See, e.g., Final Award in ICC Case No. 10188, XXVIII Y.B. COMM. ARB. 68, 91 (2003) (utilizing a success-based approach to determining allocation of costs, and finding the parties to be responsible for 75 and 25 percent, respectively).

75. See, e.g., UNCITRAL Arbitration Rules, art. 38(e) (allowing an award of costs to the prevailing party "only to the extent that the arbitral tribunal determines that the amount of such costs is reasonable").

party to see whether costs were unreasonably incurred.⁷⁶ This requires detailed analysis of the bills for costs and of the work done. This approach is not adopted frequently. Instead, the tribunal may discount the costs by an overall percentage to reflect the fact that only limited costs should be awarded.⁷⁷ Sometimes, particular heads of costs might be excluded, either because the tribunal does not consider that they form a head of recoverable cost, or because those costs should not be recoverable. Where fees are earned on a lump sum, or on a contingency basis or some other conditional arrangement, then the tribunal may decide whether those should be discounted to represent a reasonable fee. Finally, the tribunal might limit costs so that they represent a maximum percentage of the sums awarded.⁷⁸

With such a variety of approaches in international arbitration, one of the major uncertainties is determining, in advance, which approach the tribunal will take. Initially, the position is uncertain. For instance, if the tribunal has a Swiss chairman, and Australian and American co-arbitrators, what approach will the tribunal take? It may well be a totally different approach from that taken by a tribunal with an English Chairman, and Singaporean and Canadian co-arbitrators. In an arbitration where the claim is, say, \$10 million and the costs of each side are \$1.5 million, then the tribunal's decision on costs may have a serious impact on the overall recovery and the overall sum which the other party has to pay out.

Some parties try to ascertain the approach of the tribunal at an early stage to bring certainty to this aspect. Because the question of costs is a matter for the discretion of the tribunal, there is often reluctance on the part of the tribunal to commit itself to a final position.

A further uncertainty is the approach of the tribunal to methods of costs protection, which are commonly used in those jurisdictions

76. NIGEL BLACKABY ET AL., REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 546-48 (2009).

77. Cf. BORN, *supra* note 75, at 2497-98.

78. See generally Chartered Institute of Arbitrators, Guideline 9: Guideline for Arbitrators on Making Orders Relating to the Costs of the Arbitration (2010), available at <http://www.ciarb.org/information-and-resources/2010/06/14/9.%20Guideline%20for%20Arbitrators%20on%20Making%20Orders%20Relating%20to%20the%20Costs%20of%20the%20Arbitration.pdf>.

where costs recovery is permitted.⁷⁹ In many cases, one party is prepared to pay something to settle the other party's claim, but the other party will not settle the claim for the sum offered, and seeks a higher sum. Settlement often proves difficult, particularly in international arbitration, where there is a mix of cultures, approaches, and legal advice. If a party makes a claim in circumstances where the Tribunal has discretion to award costs, there is a risk that, even if that party recovers only a small amount of the claim, it will recover a substantial sum by way of costs. In such circumstances the other party may well have been prepared to settle the claim for the smaller sum, but then finds itself still having to pay substantial costs.

In jurisdictions where courts or arbitrators have discretion to award costs, mechanisms have grown up to afford costs protection in such circumstances. In some jurisdictions, there is a mechanism by which a party can "pay money into court" by way of an offer to settle the claim at that sum.⁸⁰ This procedure may apply where the claim is made in court or arbitration proceedings. In other jurisdictions, a practice has grown up of writing letters to the other party making offers to settle on the basis that those letters are not shown to the court or arbitrator until after all questions of liability and quantum have been determined.⁸¹ In those letters, one party makes an offer to the other party to settle its own claim, or the other party's claim, for a certain amount. The letter is usually written on the basis that it is without prejudice except as to costs. That letter then has the effect that it is without prejudice in terms of the merits of liability and quantum, and is inadmissible and cannot be relied upon in that context. The letter can be referred to only when the court or Tribunal comes to determine costs. This system has now replaced payment into court in the English courts, and has been applied for a number of

79. See Jonathan Wood, *Protection Against Adverse Costs' Awards in International Arbitration*, 74 ARB. 139, 141 (2008) (identifying different regional approaches to cost protection methods of settlement).

80. See PAULA LOUGHLIN & STEPHEN GERLIS, *CIVIL PROCEDURE* 387-88 (2d ed. 2004).

81. See Poupak Anjomshoaa, *Costs Awards in International Arbitration the Use of "Sealed Offers" to Limit Liability For Costs* 1, 3 (2007), available at http://www.whitecase.com/files/Publication/c7c3eda4-360d-46b7-a209-ab4b11a14597/Presentation/PublicationAttachment/80458ad9-ac22-4bea-9b64-b139dbee156f/article%20CostAwards_IntlARbit.pdf.

years in international arbitrations in common law jurisdictions.⁸²

The basis of costs protection is that the tribunal compares the amount offered in the letter with the sum awarded in the proceedings.⁸³ If the sum offered by a defendant is the same or more than a claimant recovers, then the claimant has done no better than it would have done had it accepted the offer. On that basis, the defendant has a strong case for asserting that it should have its costs from the date of the offer, although it may have to pay the claimant's costs until the date of the offer.

Similarly, a claimant may offer to accept a lesser sum than it claims. In that case, if the claimant's offer turns out to be less than it recovered, then the defendant fared worse than it would have if it had accepted the offer. The principle then applies so that the defendant has to pay the costs of the claimant. Whilst this might have been the effect of the tribunal adopting the principle of costs following the event, it provides additional comfort for the claimant. Some tribunals may award costs to the claimant on a more generous basis, applying rules of court by analogy. However, in the absence of clear rules on these "reverse offers," they can sometimes be seen as putting the claimant party in a worse position because a high reverse offer may show signs that the party was unreasonable.⁸⁴

Those rules have been developed in English law and similar rules have developed in countries which have followed the common law principles of costs recovery. The principle was first set out by the decision of Donaldson, J. in *Tramountana Armadora S.A. v. Atlantic Shipping Co. S.A.*,⁸⁵ where he put the test in these terms:

[h]as the claimant achieved more by rejecting the offer and going on with the arbitration than he would have achieved if he had accepted the offer? . . . If the claimant in the end has achieved no more than he would have achieved by accepting the offer, the continuation of the arbitration after that date has been a waste of time and money. Prima facie, the claimant should recover his costs up to the date of the offer and should be ordered to pay the respondent's costs after that date. If he has achieved more by

82. *See id.*

83. *See id.*

84. *See id.* at 6.

85. [1978] 1 Lloyd's Rep. 391 (Eng.).

going on, the respondent should pay the costs throughout.⁸⁶

Problems can arise where the amount offered includes an offer in relation to legal costs. In such cases, there is a circular question which requires the amount of costs to be determined before the tribunal can, in many cases, determine whether a party has done better or worse than the offer.⁸⁷ Generally, to be effective, an offer should be made in respect of a sum to cover the claim and should make it clear whether the offer includes interest, but should generally exclude costs.

There are also features of offers which must be borne in mind—first, that the party receiving an offer must be given a reasonable opportunity to decide whether to accept or reject the offer.⁸⁸ The period is often set at twenty-one days, but may be shorter if, for instance, the offer is made shortly before the hearing. Second, the law that applies to such offers will be the general law of contract.⁸⁹ The question may arise as to whether the applicable law is the law of the underlying contract or of the place of arbitration. This will be important only if issues arise, such as the effect of rejecting the offer, and whether, in such a case, it can be accepted later despite that rejection. Third, a party may state that, if the offer is not accepted within a certain time, it may then be accepted only on conditions.⁹⁰ Such conditions may include a provision that the other side should pay the offering party's costs from the date of the offer.

In many international arbitrations, the impact of costs recovery can have a large effect on the overall position of either, or both, the claimant and defendant. Often, practitioners who are unfamiliar with the principles of cost recovery fail to make any attempt at costs

86. *Id.* at 391.

87. See *Archital Luxfer Ltd. v. Henry Boot Construction Ltd.*, [1981] 1 Lloyd's Rep. 642 (Eng.) (raising the issue of the effect of an offer of "no order as to costs").

88. See, e.g., Civil Procedure Rules, 1998, 1998/3132, R. 36.11 (U.K.).

89. See, e.g., *Anjomshoaa*, *supra* note 87, at 5 (explaining that for arbitrations with a seat in England, the allocation of costs, including a settlement, is governed by the English Arbitration Act, but because the Arbitration Act does not address offers of settlement, tribunals turn to the national Civil Procedure Rules that govern settlement offers in contractual disputes).

90. See, e.g., *id.* at 10 n.24 (noting that in England, if a Part 36 offer is accepted after the twenty-one day time period, different rules will apply to the acceptance).

protection and expose their clients to greater risk. The main problem is to know which approaches a tribunal may take in awarding costs, and whether it will take cost protection letters into account, and, if so, on what basis?

CONCLUSION

There is no universal approach to the question of how a claim for damages can be established in international arbitration. It is too often an aspect which is ignored in the early stages of an arbitration and one which the approach of the particular tribunal is difficult to predict in international arbitration. This difficulty arises not just in relation to the assessment of the sums claimed, but also applies to interest and legal costs.

Whilst there is no solution which can overcome those difficulties, if parties are aware of the uncertainties, they can take steps at an early stage to assess the best way to establish their claims in front of particular tribunals. This means that the parties can carry out the necessary analyses to formulate robust positions and assess the risks that will increase the likelihood of successfully establishing their claims.

* * *